

Good morning and thank you, Mr. Chairman, for the opportunity to appear today. I am Wilma Schopp, and I am the Director for Benefits, Compensation, and Human Resource Operations with Monsanto/Pharmacia & Upjohn. As a life sciences company, Monsanto is committed to finding solutions to the growing global needs for food and health by sharing common forms of science and technology among agriculture, nutrition and health. I am here representing the Association of Private Pension and Welfare Plans (APPWP - The Benefits Association). APPWP is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, APPWP's members either sponsor directly or provide services to employee benefit plans covering more than 100 million Americans.

Older Americans today have new opportunities in work and retirement but at the same time confront barriers that prevent them from seizing these opportunities. My testimony will review the interest in and trend towards phased retirement programs, under which older employees who might otherwise completely retire are provided with incentives to remain actively employed.⁽¹⁾ I will then briefly review the reasons behind this trend and why we at APPWP believe that phased retirement ought to be encouraged by public policy. I will also review how employers have tried to implement phased retirement and how the law and regulations governing employee benefit plans might be modified to facilitate phased retirement programs.

INTEREST IN PHASED RETIREMENT BY EMPLOYERS AND EMPLOYEES

Labor shortage. As you know, today our nation confronts a labor shortage; a large demand for skilled workers is coinciding with an aging workforce and a diminishing number of new entrants in the workforce. Today, fourteen states have unemployment rates of 3% or less while only 6 states have unemployment rates above 5%.⁽²⁾

Moreover, demographic trends indicate that this shortage will become more acute as our population ages. The total fertility rate (the average number of children born to a woman in her lifetime) has dropped from 3.61 in 1960 to 2.04 in 1998, and it is expected to decline to 1.90 by 2025.⁽³⁾ At the same time, life expectancy has increased from 66.7 and 73.2 years for men and women, respectively, in 1960 to 73.4 and 79.4 in 1998, with steady increases expected through the 21st century.⁽⁴⁾ Consequently, the median age of workers will increase from 35 years old in 1976 to almost 41 years old in 2005.⁽⁵⁾

Advantages of retaining older employees. A clear way for a company to address this shortage of workers is by retaining its own older employees. Such retention addresses labor shortages by drawing on the fastest growing segment of the working population. According to the Bureau of Labor Statistics, in the year 2008, workers age 55 and older will comprise 16.3 percent of the workforce, up from 12.4 percent in 1998. Over the same period, workers age 25 to 54 will decline as a percentage of the workforce from 71.7 percent to 67.4 percent.⁽⁶⁾ Retention of older workers avoids the costs of recruiting and training new employees, and retains the institutional knowledge possessed by a company's long-service employees.

Continued employment of older employees is also desirable from the worker's perspective. As life expectancies increase, employees may often need to work longer to achieve financial security. Moreover, many older, vital individuals find the challenges of continued employment very rewarding.

Obstacles in retaining older employees. There are, however, significant challenges to overcome in retaining older employees. For example, many such employees would like to begin to reduce their

workload gradually. They may, for example, need time to provide care to elderly parents or they may simply want more leisure time. However, in many instances, older workers cannot afford to give up part of their salary unless they receive supplemental income, such as payments from their employer-sponsored retirement plan.

If retirement plan payments are generally unavailable to an employer's current employees, such employees will often retire completely; others may go to work for another company -- perhaps a competitor -- on a part-time basis, while receiving retirement plan payments from their first employer.

There are also older employees who would like to continue to work full-time but find it difficult to forego enhanced benefits available under the company's defined benefit pension plan if they retire immediately. For example, an employee might retire to obtain a valuable early retirement subsidy or to take advantage of low interest rates (which produce larger lump sum payments under a defined benefit plan). Again, many in this situation will cease working altogether or will decide that they can achieve both of their objectives -- continued work and receipt of the enhanced benefit from a defined benefit pension -- by becoming employed by another company.

Accordingly, a number of companies find themselves -- or foresee finding themselves -- confronted by the real possibility of losing critical, experienced workers in the midst of a labor shortage. This has led many companies to contemplate phased retirement programs.

Government Should Facilitate Phased Retirement Programs. As a matter of public policy, there are good reasons to encourage phased retirement. Phased retirement programs produce at least two efficiencies. First, as noted above, many employees who would like, and are able to, continue working on a full or part-time basis cease working because of economic incentives to do so. In the midst of a labor shortage, this is clearly inefficient. Second, also as discussed above, many other employees leave their employer for another employer due to similar economic pressures. This creates inefficiencies in terms of recruiting and training costs for both the old and the new company.

Phased retirement programs have other beneficial effects. By encouraging older individuals to remain in the workforce, phased retirement programs broaden the tax base and reduce the burden on governmental entitlement programs. Moreover, there are clearly benefits in terms of personal satisfaction for the older workers involved. Employees who can continue working in jobs that they enjoy will be more satisfied in general.

Government leadership on this issue is needed. As will be discussed below, changes in the law are necessary in order for phased retirement programs to operate most effectively. In addition, government leadership on phased retirement, by removing barriers to employment opportunity, can play a large role in improving the social and economic position of the elderly.

CURRENT APPROACHES TO PHASED RETIREMENT

Phased retirement programs may take many different forms, and the workplace is certainly still learning about the variations. This is in large part attributable to the fact that the programs are in the early stages of development. A recent survey found that only 16% of employers have such a program. However, of the companies without a phased retirement program, 28% have a moderate to high interest in adopting a program in the next two to three years. And 45% of the companies with a current phased retirement arrangement anticipate program growth over the next five years. ⁽⁷⁾

Phased retirement programs will inevitably vary sharply from one employer to another, and from one

period of time to another. The labor shortage we are facing nationally obviously does not have a uniform effect on all industries or on all regions; even within one industry in one region, there are marked differences in labor demand based on recruiting and retention practices, recent business growth, workforce age, etc. In addition, programs will vary widely from one company to another due to differences in their cultures and existing benefit plans. It is critical, therefore, that any legislative or regulatory action must contain substantial flexibility in order to accommodate the variety of programs that will be crafted to respond to these diverse needs.

Mr. Chairman, let me now describe some of the approaches employers have taken in attempting to design phased retirement programs. These approaches represent only partial solutions to the barriers in current law to employment opportunity for aging workers.

In-service distributions from a defined benefit plan. As discussed above, many older employees who would like to continue to work full-time terminate employment in order to avoid losing valuable benefits -- such as early retirement benefits or a favorable interest rate -- under their employer's defined benefit plan. To prevent such terminations of employment, the plan's normal retirement age could be amended to be the earlier of (1) age 65, or (2) a combination of a lower age and an amount of employment service. All employees who have attained this modified normal retirement age would be permitted to elect to receive a distribution of their benefit without terminating employment. Yet such an approach can prove costly and can produce problems under the pension nondiscrimination rules.

In-service distributions from a 401(k) plan. If an employee works for a company that has no defined benefit plan, the company's 401(k) plan may be the only source of supplemental income. If the employee is over age 59½, the section 401(k) plan rules permit withdrawals while the employee is still working. However, the law does not permit such "in-service" withdrawals from a 401(k) plan (in the absence of hardship) when the employee wishing to phase down employment is under age 59½.

Part-time employment issues. Phased retirement programs can facilitate part-time employment by older workers, but such programs may need to address the treatment of part-time employees under the employer's retirement and other employee benefit plans. Employers who might wish to eliminate the less favorable treatment of part-time employees under its benefit plans in the case of older employees who are phasing down could cause the affected plans to run afoul of various technical rules.

PUBLIC POLICY RECOMMENDATIONS

General Principles. APPWP believes that certain general principles should guide the development of legislative and regulatory proposals concerning phased retirement. First, flexibility for employers must be ensured. Economic and demographic assumptions will always be changing, and companies should not be caught in rigid benefit structures. Employers must retain the ability to modify and terminate any phased retirement arrangement they adopt, or such programs will not be implemented. Thus, flexibility must be a guiding principle of any policy initiative affecting phased retirement if such initiative is to meet with success in today's workplace. Second, any changes in the law should be predicated upon the knowing and voluntary participation of the employees eligible for a phased retirement program.

In-service distributions. As discussed above, employees often terminate employment to obtain an early retirement subsidy, a lump sum distribution from a defined benefit plan based on a low interest rate, or enough money to enable them to work part-time for another employer. Present-law restrictions on in-service distributions limit employers' ability to prevent such terminations of employment. To address this problem, we recommend that defined benefit plans and 401(k) plans be permitted to make in-service distributions to older employees who have attained a specified age, who have completed a specified

amount of service, or who have achieved a specified combination of age and service.⁽⁸⁾ APPWP is currently developing specific recommendations in this regard and would be pleased to advance our recommendations to the Committee. An employer could, of course, decide not to offer such in-service distribution options at all under its plan, or could decide to offer it only to a nondiscriminatory subset of the employees who have qualified for it.

We would recommend that such in-service distributions may be of some or all of an employee's benefit and may be made in any form that the phased retirement program permits (subject, of course, to otherwise applicable rules, such as the rules regarding spousal consent to distributions not in the form of a qualified joint and survivor annuity). In addition, distributions would be permitted without regard to whether an employee actually reduces his or her work schedule.⁽⁹⁾

Facts and Circumstances Standard for Nondiscrimination Rules. Properly conceived, a phased retirement program will not be discriminatory towards lower paid employees. However, such a program could nonetheless violate the mechanical nondiscrimination rules that apply under the Internal Revenue Code (Code).⁽¹⁰⁾

A facts and circumstances nondiscrimination rule, on the other hand, would permit a phased retirement program while prohibiting any abusive programs that primarily benefit highly compensated employees. We want to thank you, Mr. Chairman, for including such a provision in the comprehensive pension reform legislation, S. 741, introduced by you and Senator Graham of Florida.⁽¹¹⁾ As you know, this proposal to add a facts and circumstances standard to the nondiscrimination rules is now part of the minimum wage/tax package that has been approved by both the Senate and House of Representatives. We thank you for your championing of this provision and urge the members of this Committee to assist in its passage.

Regulatory Flexibility. There are numerous technical rules contained in the Code, the Employee Retirement Income Security Act (ERISA), and the corresponding regulations that were designed without consideration of phased retirement, which has only recently surfaced as a critical issue. In order to facilitate the development of phased retirement programs, many of these rules need to be reevaluated. However, because phased retirement programs are at a very early stage, it is not yet clear which rules need to be modified and how they should be modified. All of us have limited knowledge regarding how tomorrow's phased retirement programs will be structured.

Accordingly, we recommend that the Secretary of Treasury and the Secretary of Labor be authorized and directed to prescribe regulations by a specified date permitting the maintenance of bona fide phased retirement programs. It is intended that the regulations would enable such programs to operate effectively without running afoul of the myriad of technical rules that apply under the Code and ERISA. Treasury and Labor would have broad authority to provide appropriate relief from both statutory and regulatory requirements that would have unintended adverse effects on phased retirement programs. Of course, if it becomes clear that legislative modifications are necessary, these can be pursued at a later date to supplement this more general grant of regulatory authority. APPWP urges in particular that the following issues be addressed under this grant of phased retirement regulatory authority:

An important issue for the regulations would be to clarify the notice rules with respect to an employee who meets the age and/or service requirements applicable under a phased retirement program to receive in-service distributions under the employer's defined benefit plan. A clear explanation of the available in-service distributions must, of course, be set forth in the plan's summary plan description. However, as under present law, the harsh and burdensome suspension of benefits rules should not apply prior to a plan's normal retirement age. Thus, in the case of an active employee who does not elect in-service

distributions after qualifying for such distributions under an employer's phased retirement program, the plan should not be subject to the suspension of benefits rules.

Any regulations should permit employers to experiment with phased retirement programs without commitments to continue to maintain the program (or any feature of the program). Of course, at the same time, the regulations should ensure that employees' legitimate expectations are protected by requiring clear notice of who is eligible for the program and of the employer's right to terminate the program.

Social Security Retirement Earnings Test. The Senate recently passed H.R. 5 (which the President is expected to sign) to repeal the "Retirement Earnings Test" ("RET") for workers aged 65 and older. APPWP has long advocated the repeal of the RET and applauds the action of Congress. Prior to this change, in the case of a Social Security beneficiary who has attained age 65 but not age 70, Social Security benefits in 2000 would be reduced \$1 for every \$3 of earned income above \$17,000. For beneficiaries who have attained age 62 but not 65, the reduction in 2000 is \$1 for every \$2 of earned income above \$10,080.

This RET provides an incentive for an older individual to cease working, and its repeal by the Congress removes an important disincentive to work that has hampered phased retirement arrangements. Moreover, repeal of the RET enables a worker who has reached age 65 to phase down his or her workload (instead of terminating employment) and supplement his or her reduced salary with Social Security benefits. In this way, repeal of the RET is critical for the millions of workers who wish to continue working but whose employers do not have a phased retirement program. When a worker's employer has a phased retirement program, repeal of the RET can provide an important complement to the employer's program. Because of the many beneficial effects associated with the RET repeal, APPWP urges the Committee and the Congress to also explore elimination of the earnings test for those workers aged 62 to 64.

CONCLUSION

As our labor shortage grows and our population ages, the need for phased retirement programs increases correspondingly. These programs bring a wide array of benefits to employers, employees, and the government. Government support and recognition of the need for flexibility are critical to the growth of these programs. APPWP urges this Committee to consider the issues and recommendations found in our testimony, and we would welcome the opportunity to provide additional information and recommendations as the Committee delves more deeply into this important, emerging retirement policy issue.

Thank you for the opportunity to testify today, and I welcome any questions that you may have.

¹ There is no formal definition of "phased retirement." Retirement is traditionally viewed and practiced as a discrete period of life that follows the period of an individual's working career without any overlap between the two. For the purposes of this testimony, phased retirement will refer to the situation in which an older individual is actively working for an employer part-time or on an otherwise reduced schedule as a transition into full retirement. Phased retirement may also include situations in which older employees receive some or all of their retirement benefits while still employed full-time.

² Testimony of Richard W. Judy, Director, Center for Workforce Development, Hudson Institute, before the Subcommittee on Oversight and Investigation, Committee on Education and the Workforce, U.S. House of Representatives, February 17, 2000.

³ Table II.D2, 1999 OASDI Trustees Report, Social Security Administration.

⁴ Table II.D2, 1999 OASDI Trustees Report, Social Security Administration.

⁵ "Phased Retirement: Reshaping the End of Work," Watson Wyatt Worldwide, 1999.

⁶ "Labor Force Projections to 2008: Steady Growth and Changing Composition," Fullerton, *Monthly Labor Review*, November 1999, U.S. Department of Labor, Washington, D.C.

⁷ "Phased Retirement: Reshaping the End of Work," Watson Wyatt Worldwide, 1999.

⁸ An example of a trigger for such in-service distributions would be the attainment of age 55 or completion of 30 years of service with the employer. As noted in the text, different age and/or service triggers could be used. APPWP strongly urges the Committee in considering such modifications to give ample regard to providing as much flexibility as possible to employers who have different and fluid employee demographics and unique competitive considerations.

⁹ Any rule that conditioned in-service distributions on a prescribed reduction in an employee's work schedule would fail to be effective with respect to employees who would like to continue to work full-time but terminate to obtain a current distribution. Such a rule would also be exceedingly difficult to administer. It would require hour counting not required for any other purpose and would require a host of exceptions and special rules, such as for sick leave, vacation leave, variations in schedule, project-based work, etc.

¹⁰ Currently, the nondiscrimination rules under Code section 401(a)(4) and the coverage rules under section 410(b) consist of a series of complicated mechanical tests that seek to measure the coverage and benefits afforded to highly compensated employees relative to nonhighly compensated employees. When these rules were first developed, they were generally not mechanical but rather were applied based on all the facts and circumstances. However, the flexible facts and circumstances standard was replaced with more rigid mathematical tests.

¹¹ Section 605 of The Pension Coverage and Portability Act (S. 741) provides in pertinent part that the "Secretary of the Treasury shall, by regulation, provide that a plan shall be deemed to satisfy the requirements of section 401(a)(4) of the Internal Revenue Code of 1986 if such plan satisfies the facts and circumstances test under section 401(a)(4) of such Code, as in effect before January 1, 1994, but only if--

(1) the plan satisfies conditions prescribed by the Secretary to appropriately limit the availability of such test, and

(2) the plan is submitted to the Secretary for a determination of whether it satisfies such test."